FINANCE FOR CONDOMINIUM RENOVATION IN HUNGARY

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INTRODUCTION

The 1990s brought significant changes to the composition of the Hungarian housing stock. Several hundreds of thousands of formerly state-owned houses suddenly became part of the owner-occupied sector, in the condominium form. After privatization the task of renovation of the buildings became solely the responsibility of the new owners. The experience of the first years of functioning of the new condominiums shows very differentiated picture; while some of the buildings managed to achieve substantial renovation, in the majority of the cases only smaller repair works have been carried out, based on the savings of the owners, without taking any loan into consideration.

At the same time changes in certain banking rules, together with the modernization of the Condominium Law in Hungary, has made it easier for condominiums to get outside financing for renovation of commonly owned areas. The issue is a significant one because there are over one million condominium units in Hungary, comprising 25 percent of the nation's housing, and many face critical repair needs.

The need for renovation works in condominiums is escalating because housing estates built in the 1970s are reaching a critical point with worn-out systems after 30 years of operation. Also visible in downtown areas are older apartment buildings in deteriorated condition which require extensive work to survive in the coming decade.

The recent changes in the regulations open up new mechanisms to start solving the technical problems on a large scale. As an example, the new condominium law makes possible to issue joint loan that means one loan to the whole condominium. According to the new rules, collateral for loans can be commercial space owned by the condominium or other condominium property as an alternative to liens on individual flats. This is a new flexibility that should increase the volume of loans. The changes in the legal background create a more efficient mechanism to collect payment arrears from delinquent owners, which can strengthen the internal financial condition of condominiums and position them to undertake renovation projects.

By now several forms of subsidized loans have developed like German loan, TEK-program, housing-saving banks, repayment-subsidized loan. (There is a short description of them in the appendix.) Both of these forms have basically the same problems by issuing loans to condominiums. These problems are mainly rooted in the banking practice and in the attitude of representatives of condominiums towards banking mechanisms. In a subsidized loan system, the payments are small enough that affordability does not appear to be a major problem unless a truly major renovation scope is considered. So in conclusion, both the attitude of banks and condominiums should change.

USAID CONDOMINIUM RENOVATION PROJECT

For the past two years, USAID has been sponsoring several pilot projects in three cities in Hungary, in part to demonstrate the feasibility of new loan systems. The project has been implemented by the Urban Institute of Washington, DC, and Városkutatás of Budapest.

The overall goal of the project is to facilitate improvement in the condition of the existing multifamily housing stock. During this project, scheduled to be completed by March 1999, American and Hungary condominium experts have selected and initiated implementation of technically and financially feasible projects to improve common areas in privatized apartment buildings. Condominium partners include condominium owners associations, local governments, property managers, construction contractors, and lenders.

The project is assisting owners with assembling financing for rehabilitation from one or more of the following sources:

The owners own funds (cash or savings)
The owners association s renovation account
Bank loans eligible for the central government loan repayment subsidy
Municipal loans and subsidies
Housing Savings Bank accounts (contract savings)

Visits to local branches and central offices of banks with owners and common representatives have been emphasized, to explain the project, to investigate experience with condominium lending (subsidized and unsubsidized), to determine interest in participating in the project, and to provide information on project experience as it goes forward. Issues to be addressed with lenders include:

Loans to owners associations as opposed to individual owners
The problem of individual owners who are unable to pay
Possible role of the city as guarantor or co-financier

Assistance has been provided to the local governments to design rehabilitation loan programs or re-design existing programs, in some cases, to increase their effectiveness.

ANALYSIS OF THE CONDOMINIUM FIELD AS A MARKET FOR BANKS

In September 1998, a survey examining 800 condominiums was carried out, in the donation of USAID, where the common representatives were questioned. The largest part of the sample was from Budapest, while the supplementary samples were from Gyõr and Nyiregyháza. The core of the sample was formed by privatized buildings, but buildings built originally as condominiums also participated in the sample, while cooperative houses were totally excluded from the sample. Their share in reality is about 6,500 buildings 125,000 units as compared to 68-70,000 condominiums about 1 million units. Because of the Budapest predominance in the sample, inner city buildings and buildings with a large number of units are also over-represented.

The survey does not examine the households but the whole of the buildings. This is so partly because the estimates concerning incomes and habits, especially as an opinion of the common representatives, are quite untrustworthy, and partly because indirect data (external and internal arrears) characterize the real limits of the activity of the house better.

In the comparisons, we mainly used the data relating to one flat to exclude the distortions rooting in the number of flats in the buildings.

Renovation and Operation Accounts

The Market of Renovation Accounts

According to the survey, about 8 percent of the condominiums do not dispose of any account. However, this ratio may be higher, as the buildings with a smaller number of flats where this is typical are under-represented in the sample.

Renovation accounts are a very attractive market segment for banks, as these usually mean fixing of assets for a longer term, even longer than a year, with relatively larger sums.

According to the survey, 73 percent of the condominiums have renovation funds. However, the distortion of the sample corrects this downwards to 67-70 percent. Ninety percent of the renovation funds also mean a separate account. We did not find a significant difference in this parameter between privatized condominiums and buildings originally built as condominiums. There was more of a difference regarding the number of flats, and the positioning and technical condition of the flats. Not fully half of the smaller buildings with less than 10 flats dispose of a renovation account, as they often simply divide the costs occurred among them. The share of buildings disposing of a renovation fund is also much lower than the average among buildings in the inner districts of Budapest. The buildings built before 1950 and in a bad condition are in the worst situation. In the case of these buildings, the ratio of those with sums saved for renovation is hardly more than 50-60 percent. Neither do 40 percent of the houses in the best condition find it necessary to form a separate fund. It is the buildings of an average quality, situated in housing estates with a large number of flats in the house, which have renovation funds in the highest ratio, reaching 85-90 percent. Cities in the countryside demand special attention, as the ratio of those forming a fund may be above 90 percent here.

The amount in renovation funds, taking into account the structure of condominiums in which the ratio of buildings with less than 10 flats is around 40 percent, is about HUF 10 billion. (If the accumulation behavior of cooperative houses is the same, then they may mean a further HUF 1 billion.) In the case of buildings originally built as condominiums, this average sum is substantially higher than that for the privatized houses.

Operation Accounts

Operation accounts mean high velocity great amounts. This fact is important, first of all, from the point of view of the banking income from the handling fees. The estimation of the monthly operational funds is extremely difficult because, depending on which items are involved in these, we may get completely different amounts even for buildings with the same number of flats. The monthly fee is much higher in Budapest (around double that in the countryside), often because water meters are not installed. The monthly contribution is the highest in the case of units in housing estates, while being the lowest in the houses built in the 1950s and 1960s. Altogether, on a national scale, there may be approximately monthly HUF 4 billion moving on the operation accounts.

The Scope of the Works Performed and the Potential Renovation Market

It is a very difficult task to estimate the most necessary renewal works and their cost demand for this to represent a real value. In the survey, we asked the common representatives what works they considered important in the next five years, and how high they valued the costs of these. The analysis of the estimates by types of works showed that the ideas are not so far from the real value experienced on the market. Thus, it is worth projecting the renovation backlog, which is urging on a short term to a national level as well. The value of this, with an approximate estimation, is HUF 130-150 billion. Other estimates have also been published, which deem that a HUF 1500-3000 billion worth of renewal works are necessary on a national level; however, these do not represent only the renewal demand of the commonly owned spaces, but also that of the individual flats. However, the demand estimated by the common representatives may be substantially closer to the reality, as the lists usually involve only the works which are really urging, and they do not target a perfectly renewed state.

It turns out clearly from the survey that the cost demand of houses in housing estates is much lower than that of city or suburb houses. (This result stems only partly from the fact that housing estate houses are larger on the average, and thus their renewal demand falling on one flat is smaller.) At the same time, the renewal demand of housing estate houses is about the half that of the houses built originally as a condominium, supposedly because of the more continuous maintenance. There is a definite relationship between the age of the house and its renewal demand. The per unit cost of smaller buildings is also higher.

The most urgent for most of the buildings is the renewal of the roof, while renewal of the staircase was second place.

Arrears

Public Utility Arrears of Condominiums

Ninety-two percent of the houses do not have public utility arrears of more than 6 months. At the same time, in 52 percent of the houses, there are arrears in the condominium fees that is, the internal difficulties of the condominiums hardly appear externally. We experienced a somewhat higher than average ratio in the case of housing estates and privatized houses. We found a significantly higher value with a ratio of public utility arrears of around 30 percent in the case of the largest houses with several hundreds of units. Of the two cities in the countryside, in Nyíregyháza the ratio of houses with public utility arrears is around 14 percent, while in Gyõr this number practically equals zero. The public utility arrears situation of the smaller condominiums built a longer time ago is substantially better than the average. It is interesting that the houses in the inner districts which are physically in poorer condition and which, in about half of the cases, do not dispose of reserves have a somewhat lower than average arrears both externally (in public utility fees) and internally (in condominium fees). The public utility arrears usually mean water and sewerage fee arrears because these are more difficult to sanction.

Condominium Fee Arrears of the Dwellers

In about half of the cases, there was absolutely no arrears in condominium fees. In the other half, the distributions show very different categories. The arrears per unit are substantially higher in Budapest than in the countryside. The arrears are also significant in Nyíregyháza, while being unimportant in Gyõr. Internal debt was accrued, especially in the really old houses and in the housing estates built in the 70s - 90s. In the housing estates it is not only the total amount of the arrears which is higher, but also the ratio of those who have arrears at all that is, 75 percent of the houses have some kind of arrears. In privatized houses, the amount of the arrears per unit is much higher than in buildings built originally as condominiums.

The arrears were higher than 40 percent of the budget in 3 percent of the houses (mainly privatized housing estate buildings). At the same time only 20 percent of the condominiums have more arrears than 10 percent of their total budget. Although, the public utility fee arrears and the internal condominium fee arrears of the house still show correlation especially in housing estate houses with an elevator and many flats in large inner district houses. For example, the great internal debts have not yet burdened the budgets of the houses so much as to show the signs of insolvency externally.

According to the estimation of the common representatives, in 40 percent of the cases the debtors are not able to pay, while in 60 percent of the cases they are not willing to pay.

Management Practice of Condominiums

Eighteen percent of the condominiums have a regular surplus of income besides the covering of the operation costs and besides the renewal fund. This is the only variable which does not show a difference taken by the main groupings either, thus showing a value around 18 percent in all the categories of flats.

Half of those disposing with an income surplus fixes this deposit and 20 percent of the houses spend it on maintenance, while 15 percent spends it on renewal. The purchasing of securities is vary rare.

From the point of view of the banks, it is important that income surpluses are planned only in 25 percent of the cases. Projected on the whole population, this is only 4 percent.

Concerning the financing of renewals, it can be stated that it is the renovation funds which basically serve as the financial background for these, and regarding renewal funds, we have clearly shown that these, in their present state, can only finance a slight fragment of the renewals in the following years. Occasional contributions also play a similarly important role. The raising of the condominium fees and local government support are also important sources. These versions are usually combined. Only 3 percent of the houses in the survey financed their renewal from bank credit.

The Group of Those Potentially Taking Loans

Those Entitled to State Support

About 20 percent of the condominiums are entitled to credit with a state support on repayment. This ratio is smaller in Budapest and higher in the countryside. In housing estates it may reach 30 percent, and in suburbs even 40 percent. In the case of the houses originally built as a condominium, this ratio is very low around 10 percent. However, in the case of privatized houses this ratio is above the average. Unfortunately, the houses in the worst condition have the least possibility to take state support (6 percent).

The target group of state support is formed mostly by the privatized, the suburb, and the housing estate houses built between 1950 and 1980. Unfortunately, this target group does not cover those who have heard about the state support. In the countryside this information has reached very few houses, and housing estates and suburbs also have a lack of information. It follows from this that the formation of the renewal fund is much sooner by chance than by conscious preparing.

The Group of Those Disposing of Commonly Owned Spaces Which Can Be Mortgaged

Forty percent of the houses have answered that they have a space which may be rented, sold, or built in. The majority of these, however, is a cellar or an attic, and is usually not usable in its present state to be mortgaged. The group that declared that they have a space which they rent presently can be taken as more certain. Twenty-three percent of the houses belonged to this category. The over-representation of certain groups does not decrease this number. To the contrary, it supposes a higher number.

From the point of view of the rented space, the different buildings are basically in the same situation with smaller differences to the advantage of housing estate buildings, newly built buildings in better condition, and buildings with a large number of flats. It is interesting, that the income per flat is not the highest where renting is the most frequent, but contrarily. From the point of view of income, the city buildings with a small number of flats and with old buildings have an advantage, and if income correlates with the value of the space which we can rightly suppose then the really high value real estates can be found in the previously mentioned areas.

Different Target Groups of Renewal Financing

According to the numbers gotten from the survey, projected on the whole stock of condominiums, about 10-12 percent of the financing of the average urgent renewal demand HUF 130,000 per flat is covered from the renovation funds, while other incomes rental fees mean a further 0.5-1 percent. There are different possibilities for the financing of the remaining costs, among others bank credit.

However, not all condominiums mean an equally good market; and under present banking conditions, only the communities with an adequate economic management can meet the requirements. According to the survey, these are approximately the following:

We found 96 houses (11.8 percent) from among the 812, where there is both a renovation fund and other sources of income, and at the same time there is no condominium fee arrears at all, or only to a very small extent. As a counterpart of these, we discovered 42 buildings (5 percent) which have no official own sources, and at the same time are struggling with high arrears. Further breaking down of these groups is not advisable because of the small number of the elements.

From among the 812 houses, we found 14 (1.7 percent) which can be regarded as ideal from a banking point of view that is, which are entitled to state support, the condominium fee arrears of which is less than 10 percent of their annual budget, which have no public utility fee arrears, have a continuous income surplus, and dispose of a commonly owned space.

There was a particular question in the questioner that asked the common representative whether the building would apply for a bank loan with the guarantee of the local government that is, in parallel able to pledge all the accounts of the condominium. The answer was yes in 40 percent of the cases. There was no significant difference among the housing types and locations.

Local Government Support

The data for this chapter was taken partly from the 812 questionnaires analyzed already until now, and partly from the telephone conversations we made with all the districts.

Local government support is of outstanding importance from the point of view of Budapest houses (in the countryside such a system is very rare). In 1998 Budapest districts alone spent about HUF 900 million on about 1500 buildings in the form of repayable and non-repayable support. This was complemented by the HUF 250 million spent by the capital s local government. About 30 percent of the total support is repayable and interest free (program of nine districts). In two districts, the collateral is mortgage; in the others, pledging the account is enough, so the requirements related to collateral make it easy to get a loan.

One hundred eighteen buildings from among the buildings examined in the survey received local government support. This means 20 percent of the 573 houses in the Budapest sample. The houses usually do not receive the full amount requested, only a larger part of that on the average, HUF 800,000 per house.

It is mainly old inner-district houses that received support, which can be explained, first of all, by the fact that it is mainly the inner districts that have a support system with larger sums. It is not the houses in the poorest condition that received support, but those in medium condition.

It is interesting that the houses which received support show a worse picture than the average with regard to their main parameters. This is so despite the fact that none of the programs stated explicitly that they intend to support buildings in a more difficult situation, and that the local governments even complied with such requirements which directly or indirectly exclude the worst houses from the system. A higher than average number of houses which did not have a renewal fund also received local government support. Their public utility fee arrears were also higher than the average. Their condominium fee arrears were much higher. It is one and a half times more frequent for the building to have arrears, and the value of these are one and a half times as high as the already very high Budapest average.

In spite of the fact that the houses participating in the programs are worse than the average from different points of view, repayment morale in the case of repayable support is excellent. There is practically no building with arrears; it is mostly because of the change in common representatives that a couple of months long delays arise.

RENOVATION FINANCING PROJECT RESULTS

The following principles formulated as a result of the demonstration project to date should be of particular interest to lenders.

Joint Loan

Since the new Condominium Law came into effect, loan programs have been increasingly geared toward making a combined, single loan to a condominium association rather than a series of separate loans to individual families. This allows the lender and the owners to avoid the cumbersome paperwork and various fees and charges for multiple separate loans, and results in one larger monthly payment from the owners association rather than smaller payments from the individual owners. Smaller problems and costs of collection, as well as loan origination, are resulting in lower costs for the bank and for the individual owners in a condominium.

Options for Collateral for Joint Loans

Association-Owned Premises as Collateral

If a condominium owns a separately registered unit, the collateral for the loan may be provided wholly or in substantial part through registering a lien on this association-owned property. It is also easier to persuade all the residents to approve a lien on the joint property than to offer their own property as collateral. Common property is especially advantageous if it is used for commercial purposes, since it is likely to have a high market value and a demonstrated income stream. If there is a default on the loan, it may be more expeditious for the lender to foreclose if the property is commercial. The experience of the project was that the bank can issue bigger volume loans. In the case of joint loans, as in the case of individual liens, there are always owners that are willing to pay in cash rather then sacrifice their property.

Individual Property as Collateral

Where there is no separate marketable unit in condominium ownership, lenders usually require liens to be registered on individual property. The main factor should be that the value of the units with liens should be sufficient to serve as safe collateral for the loan, not how many units are covered with liens. In many condominiums undertaking renovation projects, some owners wish to borrow money and are willing to permit a lien to be placed on their property, while others are willing and able to pay their share of the renovation costs in cash. When a loan is taken out in the name of the association, liens should be required only on the property of owners who need to borrow.

Other Collateral

In the case of a small loan, it may be more feasible to make a loan without mortgage collateral, since the costs and administrative difficulties are not justified by the size of the loan. Banks are now willing to allow designated accounts, deposited securities and income, such as rent revenues for commercial premises, to be used as collateral.

Management of Condominiums

In considering lending to condominium associations, banks should look at the management of the condominium rather than the creditworthiness of the individual owners. A surplus in the operating budget, accumulations of reserve accounts, types of revenues, and strict enforcement of the obligation to pay monthly fees should be expected.

Other Administrative Issues

Appraisal of a property encumbered with a lien can be a serious practical issue. It is not worth requiring costly official evaluation of each unit if the loan size per unit is small. There are other techniques of combined evaluation to reduce the costs.

Other administrative conditions, such as the fees and time required for underwriting the loan, administrative costs, technical inspections, and liaison with the customers may also have a very important role in considering whether to grant a loan. Many applications fail because the common representative gets tired of collecting the necessary documents, calling extra general assemblies, and continuously reminding the residents of their obligations. The simpler the loan application procedure is and the better informed the common representative is at the beginning of the process, the better the chances are for success. And a simple procedure is less expensive for the bank as well.

Long-Term Development Trends

Municipal Guarantees

Experience shows that the most serious problem when condominiums apply for a loan is not their ability to repay it, but their ability to present the required collateral. One way to alleviate this problem is for municipalities to provide collateral in the form of a third-party guarantee.

Current Account or Lines of Credit

Several banks will provide a line of credit for individual or commercial customers who have a current account with the bank. In this case, the collateral for a smaller loan may be the current account itself. Condominiums should be considered for the same benefit. They have a continuous flow of monthly revenues and expenses, and on occasion need additional amounts for unanticipated operating expenses or for renovation.

Cash-Flow Collateral

This type of lending an expanded form of current account lending has been an established practice in the United States for years. It treats condominiums in the same manner as business enterprises; that is, the collateral for the loan they take out now is their future income. They may pledge the association's assessments or other income, such as rent from commercial property, as collateral for the loan.

Combining Different Types of State Subsidies

There are several forms of state subsidies applicable to housing finance, some of which can be combined to achieve maximum results. For example, combination of housing-savings banks and repayment subsidized loans can be considered manageable.

LESSONS LEARNED IN ASSISTING CONDOMINIUMS WITH FINANCING FOR RENOVATION PROJECTS

Attitudes Toward Borrowing

Residents of condominiums, in general, are somewhat wary of borrowing money, particularly from a private bank. However, the availability of a state subsidy for renovation loans for qualified condominiums[1] seems to provide a major advantage to potential acceptance of a loan, but unfortunately the conditions of the subsidized loan are quite unknown for the condominiums. Similarly, municipality loan programs that offer a 0 percent interest rate appear to be attractive enough to overcome fears of borrowing.

Actions Required

There are two main actions residents must take to undertake any significant renovation project involving loans. One is to agree to make monthly payments on a loan, either directly or through an increase in the common fees paid to the condominium. Second is to agree to a lien on property, which is required for most loans, either one's own flat or the common property of the condominium.

Leadership

Leadership is an important element in accomplishing a renovation project. It must come either from the common representative or members of the executive committee in the condominium. The leaders themselves must be firmly convinced of the need for renovation, and be prepared to approach members of the condominium in meetings and personal visits to "sell" the idea. Obtaining and distributing copies of a technical report on the condition of the building's systems can be useful in convincing residents of the need for repairs.

Common Fee Arrears

Most condominiums have some owners who are in arrears on payment of their common fees. This is a difficult problem to overcome in order to qualify for many loan programs. Some owners may not accept the need for continuous increases in common fees to keep up with inflation, and some pensioners and others with limited financial means have difficulty in affording the costs of ownership. However, in our pilot projects we are told most pensioners are very regular payers, and often non-payers do have the means to pay. The first step toward resolution of the problem is for the common representative and the

[1] Qualified condominiums are those which have established renovation accounts in a bank within 90 days of its foundation and h
inuously funded these accounts, or if it missed this deadline it established a renovation account at a later date and has funde
inuously for at least five years.

executive committee to take a stand against arrearages and tell the delinquent members that this will not be tolerated. After six months arrearage accrues, the association should go to court to initiate legal action and file a lien against the member's flat. Getting a judgment against the member to collect on a lien is a lengthy uncertain process, but it is important for an association to take this action to demonstrate to the owners that they must take their financial obligations seriously.

Role of the Common Representative

There is a lot of work connected with financing a renovation project, and much of it must be carried out by the common representative. This includes getting expert opinion about the renovation needs, convincing members of the need for a certain renovation program, approaching a lender, and gathering documents required for a loan. Some common representatives do not have the time, the desire, or the expertise to manage this process, and a renovation project in such a building is not likely to succeed.

Grandmother Flats

One impediment to unanimous acceptance of a loan is the existence of flats which are owned by a young person but occupied by an elderly relative such as a grandmother. This arrangement provides housing for the older person while serving as an investment for the young owner. In such cases, the long term maintenance needs of the building are not as important as they are to a family planning to live in the unit for the long term. It is difficult to obtain agreement and cooperation to participate in a renovation project from such owners.

Energy Conservation Projects

The largest expense of living in a condominium are the service charges for heat and hot water. Many buildings are starting to install individual water meters, so that residents will pay directly for the water they actually consume. However, where buildings are connected to district heating plants, there has not been an opportunity for individual metering for cots of heat. This is due to the predominance of single-pipe heating systems which do not allow the heat level to be adjusted independently in each unit. In some cases, even an the heat level in an entire building cannot be adjusted because it is part of a single pipe loop for a neighborhood. National legislation now requires district heating companies to provide metering at the building level by the year 2003, which at least will enable a building to regulate its overall heating level independent of its neighbors. However, at present most condominiums do not readily move toward energy conserving renovation, such as new windows or improved insulation, because of the high initial cost and the uncertainty of recovering utility savings.

EXAMPLES OF MUNICIPAL LOAN PROGRAMS FOR CONDOMINIUM

RENOVATIONS

In the current practice the municipalities play a substantial role. Condominium subsidy programs exist mainly in Budapest where both the districts both the municipality of Budapest issue repayable or non-repayable loans. In the following paragraphs we present two good examples of the municipal programs providing repayable loan.

Budapest District XV

This outlying district has a substantial stock of less affluent condominiums, about 50 percent of them of pre-fabricated panel construction. The district started a condominium loan program in 1997 to assist with common area renovation. In both 1997 and 1998, the district assembly allocated 30 million HUF for the program, and it has been fully loaned out each year. There is an excess demand for funds, and this is addressed by funding 100 percent of the qualifying applicants but reducing the award for each to less than the full amount requested. The City Management department of the district is responsible for administering the condominium loan program.

The program design is the condominium to pay 50 percent of the renovation costs from its own funds, with up to 50 percent loaned by the District. The loan terms are 5 years at 0 percent interest. The maximum loan amount is 3 million HUF; this year, the average loan amount was 1.2 million HUF.

The loan application must be approved by a majority of owners; 100 percent approval is not required. No property liens are required for collateral. The association must agree to a contract giving the district the right to place a lien on the condominium units' "0 sheet" the main title sheet of the condominium in case of default.

There were 21 loans awarded in each of the two years of the program. This year, loans ranged from 200,000 HUF to 2.8 million HUF. The work most commonly done was roof replacement, followed by lift repairs and base lines for heat and water.

Once the loan is closed, funds are advanced to the condominium before construction starts in order to expedite the work. Repayments have begun on the 1997 loans, and there have been no defaults so far.

About two-thirds of the borrowing condominiums are pre-fabricated panel buildings. Most condominiums in the district are in large housing estates. However, the poorest condominiums cannot apply because they do not have the 50 percent cash required. The district considered easing the 50 percent cash requirement but decided that would generate too much demand for the limited amount of funds, and the district does not have the resources to expand the program.

The program has been publicized through local television and a municipal newspaper which circulates to every household in the district. Information was mailed to all property managers known to operate in the district.

Budapest District XIII

District XIII was one of the first localities to implement a renovation loan program for condominiums, starting in 1985. This very successful program is administered by the former-IKV and, as of the end of 1997, they had loaned 32 million HUF to 21 condominiums. There are no repayment defaults as yet. Their loans are repayable (0 percent interest) 5-year loans requiring property or assignment of rents as collateral.

The program's initial budget of 50 million HUF was voted by the General Assembly in 1995. Once 32 million HUF of that had been used by the end of 1997, an additional 5 million HUF was allocated in 1998 to meet the expected demand for the year. They also have available 6 million HUF that already has been repaid and is recycled directly into the program.

The pattern of demand has increased during the three-year period of operation, since the program became better known and also implemented liberalized loan guidelines. The number of loans made was:

1995 2 loans
1996 5 loans
1997 14 loans (1 application from a co-op rejected)

Two key changes were implemented for the 1997 tender, based on experience in the first two years. One was to reduce the condominium's "own share" requirement from 50 percent to 30 percent, increasing the share that could be borrowed (with a maximum loan amount 3 million HUF).

Secondly, collateral requirements were loosened to allow a wider variety of types of collateral. Because owners are wary of having liens on individual flats, the program now allows the pledge of commonly owned property. This must be a space that is rented out, either as commercial or residential space. The municipality takes an assignment of the rents, so in case of default it could use them directly for loan repayments. The amount of monthly rent must be at least equal to the loan installment amount. The space does not necessarily need to be a registered sub-unit, because the municipality can place a lien on the common condominium deed. This has been done based on a simple majority vote of the condominium.

Another innovative source of collateral is a contract with the municipality that states the condominium will forgo collecting common fees on municipally owned units, for a period necessary to repay the loan. This can be used for either commercial or residential units owned by the municipality. Some buildings still use individual unit liens (either covering all units or only a few), where they have no common property nor municipal units.

The loans thus far have primarily been to replace roofs and repair facades. Most loans have been in the 1 to 2 million HUF range, for condominiums with 20 to 200 flats, and the buildings have been located in the "better" part of the District. Poorer condominiums are likely to be disqualified by lack of reserves to fund the 30 percent, and, if there are any outstanding common utility bills, they are ineligible.

CONCLUSION

In the study we have dealt with the renovation chances of the stock of flats in condominiums, which represent an important market above 25 percent of the Hungarian housing stock. As a starting point it could be stated that the present state of the stock of condominium flats is greatly differentiated; the largest delays in renovation are concentrated on the privatized buildings (with several flats, built earlier) which represent a significant part of the stock of condominium flats. Continuous maintenance and minor renewal activity can also be experienced in these houses with the exception of the smaller part of the buildings where there is a hopeless situation, there are large arrears, and there is no renewal at all. It is a common characteristic of the present situation, however, that condominiums cover the costs of the renewal of their buildings exclusively from their own sources that is, of their savings and mostly they use the favorable support systems elaborated by certain local governments. A vast majority of the houses have not taken a loan until now, in spite of the fact that state support ensures favorable conditions for this.

The other side of the problem is that banks presently do not consider condominiums to be an important market, and only a small segment of the financial institutions have developed a product for crediting the renovation of these. Until recently, these forms of crediting were so much over-secured from the banks side (partly because of the legal regulation background) that, in practice, the vast majority of the condominiums were faced with a hopeless situation from the beginning.

We have made an empirical survey with questionnaires to examine the actual situation of condominiums, from which it turned out that a significant part of the condominiums dispose of important savings of the size of 10 billion of HUF. This, of course, is not sufficient to cover the costs of the renewal requirements totaling several 100 billions, according to experts. However, it could mean a sufficient basis for many houses for taking renovation loans. Still, in reality, the share of building renewal type of bank crediting is minimal. Only a few banks show serious interest in opening towards the condominium market, and we also feel mistrust towards the banking sphere from the side of the house owners. All this is worsened by the lack of information concerning supported and non-supported forms.

In the present situation, it is much more the local governments who assume the task of crediting. (A part of the houses, on the basis of their savings, meet the requirements set by local government programs.) As a result, the renewal of the commonly used parts of condominiums is going on at a rate ensured by local government support or repayable interest free credit, whereas in other places it is based on the own sources of the condominiums.

The situation today concerning the renewal of condominiums cannot be considered optimal in many respects. Local government support systems besides being an extra burden for the local governments inevitably refrain the condominiums demand for bank credit. Besides this, because of their obligation to generally support renewals, local governments can no longer fulfill the task which would really be their own that is to say, the support of the houses in the worst condition and the dwellers with the lowest income, on the basis of the need for assistance.

In our opinion, the role of local governments and financial institutions has to change in the domain of condominium renovations. For the larger part of the condominiums, where normal management makes savings possible, renewals shall be accomplished first of all on the basis of credit. For this, it is necessary on the part of the banks that they make the disbursing of the credits more flexible, and that they create a transparent system of assessment which is able to assess the real situation of condominiums. All this requires, not only the further strengthening of the legal background, but the development of a strong consumer oriented marketing strategy as well.

The task of the local governments should be to orient the condominium communities, which are apt for this, into the direction of the channels of bank crediting (basically with indirect methods, e.g., with guarantees) and to help condominiums to take loans even through the direct support of the most needy families. Besides this, it is the task of the local government to treat, with special means, the situation of the condominiums, which are in a hopeless situation from the point of view of using credit.

The elaboration of the suggested complex system requires new solutions and considerable efforts from the part of the local governments and the banks as well, where the methods discussed in the study may serve as a good starting point.

APPENDIX

CASE STUDIES ON FINANCING CONDOMINIUM RENOVATION PROJECTS AND SHORT DESCRIPTIONS OF SUBSIDIZED LOAN CONSTRUCTIONS

CASE STUDIES

Case Study #1

140 year-old building in the inner city of Miskolc

24 individual units (66 percent) + municipality-owned commercial premises (34 percent)

Total cost of renovation project: 2,600,000 HUF

Loan Type: Joint application for one loan to association, with liens on some of individual units

The technical condition of the building is quite poor, with most major systems needing major repair or replacement. An architectural survey of the building revealed that total renovation of the common premises would cost approximately 50 million HUF, far beyond the means of the owners. The owners association has a reserve account of approximately 800,000 HUF. The owners decided that only a partial renovation plan could be implemented and, to be affordable, this plan must be implemented over a period of several years. With the assistance of the engineer s report, the owners established priorities for the work to be done, and decided to begin with repair of problems that presented immediate danger to life and safety, including repairs to the main gas line and the water line.

The owners association applied for a joint loan to be executed by the common representative and the chairperson of the executive committee. The owners fell into several categories in terms of their method of financing the renovation:

12 Owners borrow from proceeds of loan 600,600 HUF
12 Owners payment in cash 600,600 HUF
Local government (as owner of commercial unit) payment in cash 618,800 HUF
Cash from Reserves 780,000 HUF

The actual loan amount in this scheme is about 600,000 HUF. The loan is made to the association, which is responsible under the loan agreement for paying back the loan at 12,000 HUF per month over a 5-year term. The association then assesses the appropriate share of the costs of the renovation project against each unit. Twelve of the unit owners will pay their assessment in cash, the others will use the proceeds of the bank loan to fund their share; in other words, they will borrow their share of the costs from the association funds.

Collateral consists of liens registered on the 12 units that belong to the owners who will borrow their share from the association.

At first, this arrangement may appear to be like a traditional case of individual loans; but, in fact, there is only one loan made to the association, so there is no requirement of individual loan applications with statements by guarantors and statements of income from each owner.

Instead of analyzing the financial capacity of individual families, the loan underwriting looks at the association s operating budget to determine its ability to repay the loan. In the budget estimates of the condominium, there is a continuous income surplus of 42,900 HUF per month, which provides a reliable repayment source for the 12,000 HUF monthly installment payments. The book looked to see that the surplus would cover the installments plus a cushion of extra money to cover unforeseen problems.

The residents in this building have an income standard somewhat above the average. There are no significant arrearages in condominium fees, and the increase in fees necessitated by the loan (approximately 10 HUF per square meters), which means about 500 HUF for an average flat, is not expected to create a problem for the owners.

Case Study #2

Year-old building in a housing estate in Székesfehérvár

66 units (92 percent privately owned, 8 percent municipality owned) + one commercial unit separately registered and owned by the condominium association

Total cost of renovation project: 2,400,000 HUF

Loan Type: Joint application, with joint collateral. 5-year loan, with state repayment subsidy of 50 percent

This building has problems typical of prefabricated panel construction blocks of flats. It needs a new roof, water line repair, and balcony renovation. The association has substantial reserves 1.6 million HUF which would allow a series of smaller scale renovation projects to take place over a period of time. However, according to an engineering study, large-scale renovation would be preferable from a technical standpoint. For this, the owners determined that a loan would be necessary. They agreed to use 720,000 HUF of reserve funds and to apply for a loan of 1,680,000 HUF.

The owners decided to apply for a joint loan with the state repayment subsidy to be signed by the common representative. The owners, including the local government, approved the application for the loan unanimously. This was the case because the bank did not require liens to be placed on individual units or applications to be submitted by each owner. The condominium owns a separately registered and insured commercial unit worth about 5 million HUF, and the bank agreed to accept a lien on this unit as collateral for the entire loan.

Underwriting analysis of repayment of the loan was based on the condominium s operating surplus. For the past several years, a renovation fund contribution of 10 HUF per square meter has been included in the condominium fee. The renovation fund contribution will rise to 22 HUF per square meter for five years as a result of the loan, while the operating costs of the building will remain the same. The renovation fund contribution makes it possible to form reserves on a continuous basis while repaying the loan. There are virtually no arrearages in the building, so the budget estimates and the actual payments are the same.

SUBSIDIZED LOAN CONSTRUCTIONS

Repayment Subsidized Loan

The legal basis for this form of loan is rooted in the 106/1988 government decree, that makes it possible for condominiums and cooperatives to utilize 50 percent repayment subsidy on the installments coming from the bank loan used for the renovation of common areas. The subsidy cannot be more than the interest content of the installment. The subsidy is available for the condominiums and cooperatives that meet the requirements of the 12/1977 decree of the Financial Ministry and allocate their renovation fund properly.

German Loan

This construction is based on the 105/1966 government decree. Its goal is to facilitate energy-saving renovations both in the sphere of prefabricated buildings and other types of housing. The amount of the subsidy is two-thirds of the interest, which is itself limited in the decree, in the case of prefabricated buildings. In other cases, the subsidy is 4 percent of the interest in the first five years, and 3 percent in the next five. As a result of the renovation, the building must meet the requirements of the modern energy emission standards. The maximum amount of the subsidized loan is 800,000 HUF per unit. This program allows municipalities, housing cooperatives, condominiums, constructors to participate.

TEK-Program

This is a national building-insulation program that was originated by the Hungarian Organization of Building Heat and Roof Insulators. All types of houses can have the subsidy which has a non-repayable part (60,000 HUF per flat) and a repayable loan part with a smaller interest rate.